No. 22,272

IN THE

United States Court of Appeals

For the Ninth Circuit

KAISER STEEL CORPORATION, *Appellant,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

On Appeal from the Judgment and Order of the United States District Court for the Northern District of California

APPELLEE'S PETITION FOR REHEARING

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Table of Authorities Cited

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The United States of America, pursuant to Rule 40 of the Federal Rules of Appellate Procedure, respectfully petitions for a rehearing with respect to one part of the decision entered herein on April 29, 1969, i.e., the ruling (Slip Op. 5-7) that "freight differentials" should enter into the computation of taxpayer's "gross income from mining". In result this ruling includes the costs of nonmining transportation in taxpayer's depletion base—and such inclusion is prohibited by long-standing statutory and regulatory provisions, as to all methods of computing depletable mining income.

A miner is entitled to depletion only on "gross income from mining". By statutory definition "mining" consists of extraction from the ground, specified processes in a plant or mill, and transportation—not in excess of 50 miles unless authorized by the Commissioner—from the mine to the plant or mill where the "mining" processes are applied. Section 114(b)(4)(B) of the 1939 Code; Section 613(c) of the 1954 Code.[1] In the case of iron ore and certain other ores and minerals, "mining" processes are defined as those employed to bring the crude ore or mineral to shipping grade and form, plus loading for shipment. Section 114(b)(4)(B)(iii), *supra;* Section 613(c)(4)(C), *supra.*

If a miner sells his crude mineral at the termination of "mining" processes, without exceeding the limit allowed for "mining" transportation, then his depletable mining income is, of course, his actual income. If, prior to sale, the miner applies nonmining processes or resorts to nonmining transportation, then his income from "mining" must be determined constructively. Such a constructive computation must eliminate any preference over the ordinary miner, whose depletion base is computed at the point where the raw mineral product of "mining" is ready for shipment to the market. *United States v. Cannelton Sewer Pipe Co.,* 364 U.S. 76.

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[1]Not even this limited amount of transportation was included in "mining" under Section 114(b)(4)(B) as originally enacted; it was added, for taxable years beginning after December 31, 1949, by Section 207 of the Revenue Act of 1950. The amendment is inapplicable to the instant case since the taxable years involved are taxpayer's fiscal years ended June 30, 1949, and June 30, 1950.

Since 1940 successive Treasury Regulations have reflected the foregoing statutory scheme and provided for constructive computations of "gross income from mining".[2] In its basic features the regulatory pattern has remained substantially the same over the years. If a miner's operations are confined to "mining" processes and "mining" transportation, his gross sales constitute his depletion base. (The 1939 Code Regulations speak of sales "in the immediate vicinity of the mine"; the 1954 Code Regulations (Section 1.613-3(b)(2)(b)) speak of sales after "application of only mining processes, including mining transportation, and before any nonmining transportation".) If the ore or mineral is sold after nonmining processes or transportation, the Regulations provide that the miner's depletable mining income shall be computed by reference to a representative market or field price, if such a price can be established by sales in a relevant market of a "mining" product of "like kind and grade". Where a representative price cannot be established, "gross income from mining" must be computed under the proportionate profits method.

The instant case involves a constructive computation based on a representative market or field price. From the beginning, the regulatory provisions governing such computations have explicitly required adjustments to exclude nonmining transportation altogether from the depletion base. Under the 1939

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[2]Treasury Regulations 103 (1939 Code), Section 19.23(m)-1(f); Treasury Regulations 111 (1939 Code), Section 29.23(m)-1(f), applicable to the taxable years herein; Treasury Regulations 118 (1939 Code), Section 39.23(m)-1(e)(3); Treasury Regulations (1954 Code), Section 1.613(b) through (f).

Code Regulations, depletable mining income is equated with the representative market or field price of a mineral product of like kind and grade, as beneficiated by "mining" processes, *"before"* any transportation other than transportation treated as "mining". (Emphasis supplied.) These Regulations further provide that, if the "product in its crude state is merely transported" prior to sale, then the depletion base shall be the sale price "minus the costs and proportionate profits attributable to the transportation * * *". Clearly, in keeping with the statutory definition of "mining", the 1939 Code Regulations exclude from constructive computations of mining income all transportation costs save those of moving the ore or mineral, not in excess of 50 miles, from the mine to the plant or mill where the "mining" processes are applied. Transportation after completion of the "mining" processes—for distribution, marketing or delivery—is obviously nonmining transportation, whether or not in excess of 50 miles. Accordingly, no portion of the costs of such transportation is includible in the computations.

As already noted, the definition of "mining" transportation is the same in the 1954 Code as in the 1939 Code. And the 1954 Code Regulations, like their predecessors, exclude nonmining transportation from constructive computations of depletable mining income. Thus, Section 1.613-3(c)(1) provides for the use of a representative market or field price "after the application of the mining processes (if any) actually applied and *before* any nonmining transportation, subject to any adjustments required by para-

graph (e) of this section". (Emphasis supplied.) Section 1.613-3(c)(3) and (4) provide for the use of a weighted average of competitive selling prices of minerals of like kind and grade, sold in the taxpayer's actual or potential lines of commerce, taking into account taxpayer's own competitive sales—provided, that all sales taken into account must involve minerals "beneficiated only by mining processes * * *".

In the instant decision this Court has augmented the taxpayer's depletion base by the costs of nonmining transportation to "points of consumption", to the extent that taxpayer's costs of this nature are exceeded by its competitors'.[3] We submit that this is contrary to the statutory scheme and violates the explicit requirement of successive regulations that nonmining transportation shall be entirely excluded from the depletion base.

This Court invokes in support of its ruling one sentence in Section 1.613-3(e)(2) of the 1954 Code Regulations, but that sentence, read in context, does not support the ruling. Section 1.613-3(e)(2) deals with one type of nonmining transportation, i.e., purchased transportation to the customer as defined in subparagraph (e)(2)(iii), where a computation of

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[3]The effect of this decision is to allow taxpayer to compute depletion on the *value* of the deposits attributable to their proximity to the "points of consumption." It should be noted in this connection that the Government exhibit reflecting "freight differentials" that is referred to by the Court (Slip Op. 6) is apparently one which was offered during the testimony of R. H. B. Jones, who was called as a witness only after the statement of Government counsel that "we think the evidence is irrelevant, but we are calling (*sic*) it as a rebuttal to Kaiser's value presentation." (II-R 848.)

representative market price is being made under Section 1.613-3(c). If the taxpayer applies only "mining" processes to his mineral and then ships it by "purchased transportation" to customers, it is provided that his representative market price shall be his own "delivered price" *minus* the costs of the purchased transportation. If the taxpayer does not use purchased transportation but his competitors do (and their prices otherwise qualify as representative), then the representative market price shall be the competitors' delivered prices *less* the costs of purchased transportation. The sole function of these operative provisions of Section 1.613-3(e)(2) is to ensure the elimination of purchased transportation from the computation of representative market price.

This Court relies for its ruling on the third sentence of Section 1.613-3(e)(2)(i) of the 1954 Code Regulations. That sentence, which relates only to the use of the competitors' delivered prices less costs of purchased transportation, provides that "appropriate adjustments shall be made to take into account differences in mode of transportation and distance". The evident purpose of this provision, in context, is to ensure that each competitors' actual cost of purchased transportation will be deducted from his delivered price in determining representative market or field price. This interpretation accords with the examples given at the end of paragraph (e)(2). Any other reading of the quoted language conflicts with the express requirement of all the Regulations from the beginning: That a representative price must be netted

to eliminate nonmining transportation—whether it is purchased transportation or not.

This Court's decision imports into tax depletion law a wholly new principle, unsupported by case law or administrative practice, which cannot be reconciled with either the statutory or the regulatory scheme. Nor, it may be added, can it be reconciled with the teaching of *Cannelton* that the goal of constructive computations is parity with the ordinary miner—who must compute depletion on income earned when "mining" is completed and *before* he ships his mineral to the market place.

Counsel for the United States certify that this petition for rehearing is presented in good faith and not for the purpose of delay. For the reasons given, appellant respectfully requests that the petition be granted.

Respectfully submitted,

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